

HEYWARDS

Chartered Accountants

6th Floor, Remo House, 310-312 Regent Street, London W1B 3BS

Tel: (44) 020 7299 8150 Fax: (44) 020 7299 8160

E-mail: mail@heywards.co.uk

Website: www.heywards.co.uk

Partners: Paul N Samuels BA FCA, Shashi B Patel BA ACA

Property investment through a company Tax and reporting pitfalls

Property investment through a company

Why a company?

You can choose how to hold your investment properties – as an individual, jointly with others, or through a limited company. There are other potential structures, such as partnerships involving companies or REITS, but those are geared to high-value investments.

Many serious property investors are now moving their residential properties into a wholly owned company, and buying any new properties through the same company. This leaflet covers the tax advantages and disadvantages of holding investment properties in a company that you control.

Interest payable

The tax law is changing for individual landlords who let residential properties. From 6 April 2017, individual landlords will only be able to deduct 75% of their borrowing costs, including interest, incurred in running their lettings business. The percentage of disallowed interest will increase by 25% each year until 6 April 2020, when all of the interest paid by an individual landlord will be disallowed. Instead, the landlord will receive a tax credit equivalent to 20% of the disallowed interest to set against his income tax liability.

Highly geared landlords will find they are paying tax on non-existent profits. This will make it uneconomic for those individual landlords to continue in business.

This restriction on the deductibility of finance costs won't apply to corporate landlords. A company will continue to deduct all the interest and finance costs in calculating the taxable profits of its property investment business. However, a company can find it has to pay higher interest charges or jump through more hoops to secure mortgages on its rental properties. A lender may insist that the directors of the company provide personal guarantees before advancing loans to the company.

Tax rates

Individual landlords pay income tax on rental income profits at 20%, 40% or 45%, after deduction of any available personal allowance. Gains they make on the disposal of residential properties are taxed at 18% or 28%. Which tax rate applies (on either income or gains) depends on the level of the landlord's other income in the same tax year.

Companies currently pay tax on all their profits and gains at 20%, but this rate will drop to 19% on 1 April 2017, and is expected to reduce to 17% in 2020. This disparity in tax rates makes a company seem a more attractive option, but you need to compare like with like.

Although a company can deduct all of its interest costs (see interest payable), its profits aren't available for you to spend until you withdraw the funds, as salary or dividends. A salary is taxed under PAYE and may generate an NIC charge. Dividend tax is payable on dividends received in excess of £5,000 per year. A company also has higher administrative costs than an individual landlord. The company must file annual returns and accounts at Companies House, and submit PAYE reports when it pays its directors.

Long-term plan

Most investors want to hold their properties for the medium or long term, which has the following advantages when using a company:

- The company will generally pay less tax on each property disposal than an individual. The capital gain is reduced for the effect of inflation (indexation allowance) before the net amount is taxed at 20%. Inflation-proofing isn't available for individual landlords.
- The profits from the property investment business can roll-up within a company after tax is paid at 20%, to be extracted later when the individual owner has a low personal tax rate, perhaps after retirement.
- The company can be sold as an active rental business, and any gain made is taxed at 20%. This compares favourably to Capital Gains Tax (CGT) due at 28% on gains made by an individual when he sells his portfolio of residential properties. The buyer of the company also saves Stamp Duty Land Tax (SDLT) or Land and Buildings Transaction Tax (LBTT) as he pays 0.5% on the company shares compared to rates of up to 15% on the value of the individual properties.
- Shares in the company can be passed on to the next generation more easily than a share in the investment properties.



Short-term plan

If you plan to turn over your investment properties frequently to release capital profits, the tax charges may be lower if you hold those properties as an individual or jointly with another person. In that situation each individual owner can set their annual capital gains exemption (£11,100 for 2016/17) against the taxable gains, which will reduce the effective rate of tax. A company doesn't have an annual capital gains exemption, so will pay tax at 20% on all its net gains.

Purchase costs

When purchasing an investment property you must pay SDLT (LBTT in Scotland). The rates below include the 3% supplement applied when a residential property is purchased that is not intended to replace the buyer's main home.

SDLT

Wholly residential property £	Rate including supplement %	Non-residential & mixed property £	Rate %
Up to 125,000	3	Up to 150,000	0
125,001 – 250,000	5	150,001 – 250,000	2
250,001 – 925,000	8	Over 250,000	5
925,001 – 1,500,000	13		
Over 1,500,000	15		

A company purchasing a residential property for more than £500,000 may have to pay a penal rate of SDLT at 15% on the entire cost, if one of the exemptions for enveloped properties does not apply. In most cases, the penal rate of SDLT won't apply to a company acquiring property for the purpose of a letting business.

LBTT

Wholly residential property £	Rate including supplement %	Non-residential & mixed property £	Rate %
Up to 145,000	3	Up to 150,000	0
145,001 – 250,000	5	150,001 – 350,000	3
250,001 – 325,000	8	Over 350,000	4.5
325,001 – 750,000	13		
Over 750,000	15		

There is no penal rate of LBTT on residential properties in Scotland.

The Annual Tax on Enveloped Dwellings (ATED) charge

The ATED is payable for periods from 1 April 2013 when a UK residential property is held by a non-natural person, i.e. a company, a partnership with a corporate member, or a unit trust.

ATED charges

Property value £	2013/14 £	2014/15 £	2015/16 £	2016/17 £
500,001 – 1,000,000	Nil	Nil	Nil	3,500
1,000,001 – 2,000,000	Nil	Nil	7,000	7,000
2,000,001 – 5,000,000	15,000	15,400	23,350	23,350
5,000,001 – 10,000,000	35,000	35,900	54,450	54,450
10,000,001 – 20,000,000	70,000	71,850	109,050	109,050
Over £20,000,000	140,000	143,750	218,200	218,200

Warning

The ATED charge is not restricted to new purchases. It applies to every residential property owned by a company within the valuation bands shown above, irrespective of when the property was acquired. An average home in London now falls within the ATED charge if it is owned by a company.

ATED returns

The chargeable period for ATED runs from 1 April to 31 March, but the ATED return and payment is due by 30 April within that period. For 2016/17 the ATED return had to be submitted by 30 April 2016.

Don't overlook the need to submit an ATED return. Where the property falls within the ATED regime because of its value and ownership, an ATED return must be submitted. If the property qualifies for an ATED relief you may submit an ATED relief declaration return to cover all of your properties that qualify for the same relief. There is a different ATED relief declaration form for each type of ATED relief claimed.

ATED value

The relevant value for calculating which ATED band applies is the property's open market value at 1 April 2012, or at the date of acquisition if later. If you are not sure about the value you can ask HMRC to undertake a pre-return banding check. However, you can't ask for a banding check if the ATED charge will be reduced to nil by one of the reliefs.

ATED reliefs

ATED relief can be claimed when one of the following applies to the property:

- let to a third party on a commercial basis, but not occupied by anyone connected with the owner
- part of stock held by a property trader to be resold
- in process of being developed for resale by a property developer
- used to house employees of a trading company, who don't hold a significant interest in that company
- repossessed by a financial institution as part of debt collection
- a farmhouse occupied by a farm worker or a former farm worker
- owned by a registered provider of social housing
- open to the public for at least 28 days a year

A property investment or development company will normally claim relief from the ATED charge under one of the first three conditions above. Where the property is available for letting but it is not actually let, it should qualify for relief where steps are being taken to let the property without delay.

Penalties

Penalties for late submission of an ATED return start at £100. If the form is 90 days late a £10 daily penalty applies, a further £300 is charged when the form is six months late. The total penalties due for one late ATED return can soon accumulate to £1,300 per form. One ATED form has to be completed per property, unless an ATED relief declaration form is submitted for a whole portfolio subject to the same relief.

Paying the ATED charge

When paying the ATED charge the company must quote its ATED reference number, which HMRC issues on receipt of the first ATED return from that company. When the company first becomes liable to pay the ATED charge, the ATED return must be submitted early in order to get a reference number to pay the ATED charge on time.

Warning

HMRC know exactly which companies hold residential properties, as they can search the Land Registry database for that information. The registered owner of the property must make an ATED return even if that owner is an overseas company.

VAT

A property investment company must register VAT when its Vatable turnover exceeds the VAT registration threshold (£83,000 from 1 April 2016). However, the letting of residential property is generally exempt from VAT, in which case that income doesn't count towards the VAT registration threshold. The letting of non-residential property may be standard rated or exempt, it depends on the age of the property and whether an 'option to tax' election has been made.

There can be particular VAT difficulties with service charges which are incorporated into the rent. In most cases the VAT on the service charge will follow that due on the rent, but there are exceptions, particularly where the landlord provides services such as electricity, gas or water.

Warning

VAT is extremely complex. If you are in any doubt about the VAT treatment of a property-related transaction, ask us for advice. Never rely on verbal assurances from the HMRC VAT helpline – always get the advice in writing.